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N.C. Utilities Commission

1 **BELLSOUTH TELECOMMUNICATIONS, INC.**

2 **BEFORE THE**

3 **NORTH CAROLINA UTILITIES COMMISSION**

4 **DOCKET NO. P-100, Sub 133q**

5 **SUMMARY OF REBUTTAL TESTIMONY OF**

6 **DR. CHRISTOPHER JON PLEATSIKAS**

7
8 My rebuttal testimony responds to the economic arguments regarding market
9 definition made by Dr. Mark T. Bryant on behalf of MCI and Mr. Joseph Gillan on
10 behalf of CompSouth.

11
12 Dr. Bryant's submits that the *individual customer location* is the market but that for
13 administrative practicality, the Commission may seek to use wire centers. Dr.
14 Bryant's customer location definition is not supportable as a matter of economics
15 because it ignores a critically important factor in determining geographic markets,
16 namely "substitutability in supply." This means that even if an individual wants a
17 service delivered to a particular location, firms that serve other, proximate, areas
18 may be willing to serve that particular area. In such cases, the relevant geographic
19 market is wider than the individual customer location. It should be obvious that the
20 individual customer location in no way provides an adequate definition of the
21 geographic market, nor is it consistent with the FCC's guidance that the market not
22 be defined so narrowly so that a competitor serving that market alone would not be

1 able to take advantage of available scale and scope economies from serving a wider
2 market.

3
4 The use of wire centers as the basis for defining individual geographic markets is
5 does not comport with relevant economic principles or the FCC's guidance. Such
6 an approach does not reflect factors, such as mass-market advertising, that affect
7 substitutability in supply. As a result, a firm that is considering entry into a single
8 wire center may find such entry to be unprofitable given all of the costs of entry. In
9 contrast, it may find that entry into a broader market would be profitable. In other
10 words, by failing to account for *any* of the economic factors that would contribute
11 to a wider definition of the market (such as mass-market advertising), and
12 (possibly) because he begins his analysis with an erroneous theory that the
13 individual consumer constitutes a market, Dr. Bryant erroneously arrives at a far
14 too narrow market definition. Dr. Bryant also contends that because some costs
15 may vary across wire centers, markets do not span multiple wire centers. It may be
16 true that some costs may vary across wire centers, but cost variation is endemic
17 within markets. Thus, cost variation within a geographic market is not a sufficient
18 condition for dividing that area into different markets.

19
20 A more balanced approach to market definition considers the factors that affect
21 demand- and supply-side substitutability, including factors that contribute to the

1 capture by CLPs of scale and scope economies over an area generally wider than
2 the individual wire center.

3
4 For his part, Mr. Gillan does not provide any economically-based guidance to the
5 Commission. Mr. Gillan advocates that the market definition should reflect the
6 "competitive signature of UNE-P," which is an approach that is not consistent with
7 the economic principles associated with defining relevant markets. There is no
8 economic basis for defining markets merely by evaluating the particular
9 competitive entry strategies (in this case, UNE-P) of individual firms.

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BELLSOUTH TELECOMMUNICATIONS, INC.
EXECUTIVE SUMMARY
REBUTTAL TESTIMONY OF JOHN A. RUSCILLI
BEFORE THE NORTH CAROLINA UTILITIES COMMISSION
DOCKET NO. P-100, SUB 133q
FEBRUARY 16, 2004

My rebuttal testimony addresses numerous comments contained in the direct testimony filed by other witnesses in this proceeding on January 9, 2004. Specifically, I address portions of the testimony of Mr. Joseph Gillan representing CompSouth, Dr. Mark T. Bryant, Mr. James D. Webber, and Ms. Sherry Lichtenberg representing MCI WorldCom Communications, Inc. and MCIMetro Access Transmission Services, LLC ("MCI") and Mr. Stephen E. Turner and Mr. Mark D. Van de Water representing AT&T Communications of the Southern States, LLC ("AT&T"). I address the following points:

(1) BellSouth reiterates the intent of the FCC's Triennial Review Order¹ that state commissions conduct a granular analysis of markets within the state, as opposed to Mr. Gillan's interpretation that the state's role is simply to confirm that there are no exceptions to the FCC's national finding of impairment with respect to mass market switching.

(2) Contrary to Mr. Gillan's recommendation, it is neither necessary nor appropriate for this Commission to set market rates for switching network elements in markets where CLPs are no longer impaired.

¹ *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, et al.*, CC Docket No. 01-338, et al., *Report and Order and Order on Remand and Further Notice of Proposed Rulemaking*, FCC 03-36, released August 21, 2003.

- 1 (3) Contrary to assertions by CompSouth and MCI, this Commission is not required
2 to ensure that a statewide alternative to UNE-P is in place, but is required to
3 determine that CLPs are not impaired in a market when either the self-
4 provisioning or wholesale triggers are met or the market is found to be conducive
5 to competitive entry.
- 6 (4) BellSouth disagrees with the CLPs' assertions that they cannot compete in North
7 Carolina without UNE-P or that UNE-P encourages investment.
- 8 (5) I explain why MCI's choice of the wire center as the correct definition of
9 geographic market is meaningless, and is, in fact, contrary to MCI's position in a
10 previous proceeding BellSouth's proposal to use the individual UNE rate zones
11 adopted by this Commission, subdivided into smaller areas using the Component
12 Economic Areas ("CEAs"), represents a more appropriate definition of
13 geographic markets.
- 14 (6) CompSouth and MCI recommend that a *de minimis* criterion be added to the
15 triggers test by this Commission to determine whether a self-provisioning carrier
16 can be "counted" for purposes of the test as to whether CLPs are not impaired in
17 a given market. I explain that the *TRO* does not establish any size requirements
18 or specific quantitative standard with regard to the triggers test.
- 19 (7) My testimony rebuts the CLPs' assertions that BellSouth's hot cut process is
20 flawed. In the *TRO*, the FCC made a provisional national finding regarding hot
21 cuts, but, at the same time, requested the state commissions to examine the issue
22 more closely. The FCC held that the state commissions must adopt and
23 implement a batch hot cut process within 9 months of the effective date of the
24 *TRO*. The Commission's requirements are found not only in *TRO*, ¶423, but also

1 in the FCC rules at 47 C.F.R. 51.319(d)(2)(ii), which state “the state commission
2 *shall*...establish an incumbent LEC batch cut process...”
3 (8) My testimony explains that there is no requirement that the hot cut process mirror
4 the seamless nature of UNE-P migrations and PIC changes, as advocated by
5 AT&T and MCI. Contrary to AT&T’s contention, the FCC has already rejected
6 AT&T’s proposal that the rate for hot cuts should be based on electronic loop
7 provisioning. Finally, AT&T’s complaints that BellSouth’s North Carolina hot
8 cut charges constitute an economic impairment to UNE-L should be seen for
9 what it is – a ploy to perpetuate UNE-P rather than a serious complaint about the
10 Commission’s rates for hot cuts.

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EXECUTIVE SUMMARY OF MR. JAMES W. STEGEMAN
ON BEHALF OF BELL SOUTH TELECOMMUNICATIONS, INC.
BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NUMBER P-100, SUB 133Q

FEBRUARY 16, 2004

My rebuttal testimony responds generally to AT&T witness Steven Turner and MCI witness, Dr. Mark T. Bryant. The BACE (BellSouth Analysis of Competitive Entry) model provides a granular analysis, considers CLP costs under a UNE-L strategy and allows consideration of an efficient CLP. I also filed a revised version of the BACE model with expanded optimization, corrected mileage, and a scenario that allows the user to view some of the intermediate BACE results. The BACE model provides this Commission with the appropriate tool and framework for performing the granular analysis set forth in the FCC's *Triennial Review Order* and should be utilized by this Commission.

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BELLSOUTH TELECOMMUNICATIONS, INC.

EXECUTIVE SUMMARY

REBUTTAL TESTIMONY OF GARY TENNYSON

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. P-100, SUB 133Q

FEBRUARY 16, 2004

In my rebuttal testimony, I respond to the direct testimonies of Mr. James D. Webber on behalf of MCI, and Mr. Mark David Van de Water on behalf of AT&T with regard to Competing Local Providers' ("CLPs") proposal to mechanize the hot cut process.

My rebuttal testimony begins by discussing the Electronic Loop Provisioning ("ELP") process as to what it is, how long it would take to deploy ELP in BellSouth's region, and explaining why it is neither a viable option to consider or economically justified. In doing so, I point out that first, the existing manual hot cut process is reliable. Second, ELP cannot be justified based on its cost. Third, ELP is not the best architecture to enable Digital Subscriber Line ("DSL") and would impede DSL innovation.

Next, I describe the shortcomings of MCI's argument consisting of replacing the functionality of BellSouth's Main Distributing Frames ("MDFs") with certain automated cross-connect devices. The fact is that BellSouth is not aware of any manufacturer that offers a device of sufficient scale and complexity to replace large MDFs thereby making this solution not technically available.

I also describe the reasons why MCI's discussion of loop unbundling using GR-303-

1 compliant equipment is impractical; the fact that unbundled loops BellSouth provides
2 CLPs meet appropriate technical standards and is not "technologically inferior" as
3 alleged by AT&T, and why CLPs are able to benefit from Integrated Digital Loop Carrier
4 ("IDLC") technology.

5

6 Finally, I respond to MCI's complaint regarding reduced modem speed often
7 encountered in converting an end-user, currently served via IDLC, to an unbundled
8 loop. *I use the results of a technical trial that BellSouth conducted with ITC/Deltacom*
9 *on this subject.*

10

11 *This concludes my summary.*

12

13

14

1 Bellsouth Telecommunications, Inc.
2 REBUTTAL TESTIMONY OF ALPHONSO J. VARNER
3 BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

4 FILED FEBRUARY 16, 2004

5 DOCKET NO. P-100 SUB 133Q
6

7 EXECUTIVE SUMMARY
8

9 My Rebuttal Testimony addresses various performance related issues
10 raised by the MCI witnesses James Webber and Sherry Lichtenberg and
11 AT&T witness Mark David Van De Water. The issues raised by these
12 witnesses are largely anecdotal or are based on discussing "potential"
13 problems that simply are not real problems. These witnesses frequently
14 make broad allegations of existing problems, which the actual
15 performance data contradict, and they take note of differences in
16 processes that are not only expected, but fail to take equal note that the
17 differences do not represent any problem at all.

18
19 For example, with respect to the CLPs' tendency to focus on potential
20 problems, Mr. Van De Water claims that the conversion from UNE-P to
21 UNE-L will result in operational constraints because of the "significant
22 blocking of trunks" that he argues is expected. As pointed out in my
23 Rebuttal Testimony, BellSouth consistently performs at a very high level in
24 providing CLPs with local trunking, meeting the trunk blocking criteria for
25 all 12 months for the recent period of October 2002 to September 2003.

1 BellSouth is certainly committed to continue performing at a high level of
2 service in providing local trunking to CLPs and Mr. Van De Water offers
3 nothing in his Direct Testimony except the possibility of a problem.

4
5 Regarding the second type of issue raised by the CLPs, based on
6 allegations of existing problems that are actually not problems, there are
7 several notable examples. First, Mr. Webber claims that regarding the
8 provisioning of collocation space, "it is not uncommon to experience
9 significant delays" in gaining access to this collocation space. This
10 allegation is, however, contrary to the data. Specifically, BellSouth met
11 100% of all collocation due dates in North Carolina from October 2002
12 through September 2003.

13
14 In this same manner, Mr. Van De Water alleges, with respect to UNE-L
15 orders, substandard performance in returning Firm Order Confirmations
16 (FOCs), failures related to scheduling hot cuts, erroneous disconnections
17 of end users, and undue delay in reconnection. These claims are made
18 despite the fact that for the period from October 2002 to September 2003:
19 over 97% of the LSRs for UNE Loop orders (which includes hot cut
20 orders) received a FOC within the intervals established by the
21 Commission; BellSouth met the performance standard for 99% of the sub-
22 metrics for the Average Completion Notice Interval measure; UNE Loops
23 received more than 98% trouble-free service; and BellSouth met the
24 performance standard 94% of the time for the Maintenance Average
25 Duration measure. So, at every turn Mr. Van De Water's claims of poor

1 service are met by actual performance results that refute these claims.

2

3 Similarly, Ms. Lichtenberg alleges that because BellSouth's hot cut
4 process includes some manual work this process often results in errors
5 and delays. Yet she offers no evidence to support her allegation that the
6 'process often results in errors and delays.' Again, the performance
7 results contradict this claim. As pointed out in both my direct testimony
8 and my rebuttal testimony, looking at the three primary hot cut
9 measurements in North Carolina (Coordinated Customer Conversions,
10 Hot Cut Timeliness, and Provisioning Troubles within 7 days of Cutover),
11 BellSouth achieved the established standard on 100% of the sub-metrics
12 over the 12-month period provided (October 2002 to September 2003).
13 These results show Ms. Lichtenberg's comments to be unsubstantiated.

14

15 The final category of the CLPs' purported issues, namely cases where
16 they identify expected differences in processes and claim that the
17 differences are a problem, both Mr. Van De Water and Ms. Lichtenberg
18 offer illustrations of this point. These two witnesses point out that the
19 Order Completion Intervals for UNE-P and UNE-L are different, and on
20 that basis conclude that UNE-L performance is inferior, implying that they
21 are impaired as a result of the difference. These comparisons are invalid,
22 as I pointed out in my Rebuttal Testimony, and do not indicate that CLPs
23 are impaired due to the difference.

24

25

1 The real essence of what Mr. Van De Water and Ms. Lichtenberg allege is
2 simply that it takes less time on average to complete UNE-P orders, which
3 are predominantly orders requiring a records change only, and no physical
4 work, than the time involved on average to complete UNE-L orders where
5 some form of physical work is always required. The more important and
6 relevant point, however, is that, as demonstrated by the data provided in
7 my testimony, BellSouth consistently meets both the UNE-P and UNE-L
8 standards established by this Commission for these two different
9 functions.

10
11 I have presented a few examples of the types of issues raised by the
12 CLPs in this proceeding relative to loop provisioning and the hot cut
13 process, but these examples are representative of the unsubstantiated
14 and speculative nature of the issues consistently raised by the CLPs. My
15 testimony includes actual performance data, verified by independent third
16 parties, which BellSouth provides to this Commission on a monthly basis
17 for its review. These data provide the Commission with a demonstration
18 of solid and consistent current performance from which the Commission
19 may rightly infer that BellSouth will continue in the future to provide this
20 high level of service.

21

**BELLSOUTH TELECOMMUNICATIONS, INC.'S
SURREBUTTAL MATRIX SUMMARY OF POSITIONS
DOCKET NO. P-100, SUB 133q**

WITNESS	SUBJECT MATTER OF TESTIMONY	TRO DECISIONAL CRITERIA
Kenneth L. Ainsworth	Hot cut processes	47 C.F. R. §51.319(d)(2)(ii)
Dr. Debra J. Aron	Potential deployment test	47 C.F. R. §51.319(d)(2)(iii)(B)
Randall S. Billingsley	Economic barriers to CLEC entry	47 C.F. R. §51.319(d)(2)(iii)(B)(3)
Eric Fogle	Hot cut processes	47 C.F. R. §51.319(d)(2)(ii)
A. Wayne Gray	Potential deployment test	47 C.F. R. §51.319(d)(2)(iii)(B)
Alfred A. Heartley	Hot cut processes	47 C.F. R. §51.319(d)(2)(ii)
Milton McElroy	Hot cut processes	47 C.F. R. §51.319(d)(2)(ii)
W. Keith Milner	Potential deployment test	47 C.F. R. §51.319(d)(2)(iii)(B)(3)
Ronald M. Pate	Hot cut processes	47 C.F. R. §51.319(d)(2)(ii)
Dr. Christopher Pleatsikas	Geographic market area	47 C.F. R. §51.319(d)(2)(i)
John A. Ruscilli	Policy issues	47 C.F.R. §51.319(d)(2)(i), (ii), and (iii)
James W. Stegeman	Economic Model – BellSouth's Analysis of Competitive Entry ("BACE")	47 C.F. R. §51.319(d)(2)(iii)(B)
Pamela A. Tipton	Local switching triggers	47 C.F. R. §51.319(d)(2)(iii)(A)
Alphonso J. Varner	Hot cut processes Potential deployment test	47 C.F. R. §51.319(d)(2)(ii) 47 C.F.R. §51.319(d)(2)(iii)(B)

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BELLSOUTH TELECOMMUNICATIONS, INC.

EXECUTIVE SUMMARY

SURREBUTTAL TESTIMONY OF KENNETH L. AINSWORTH

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. P-100, SUB 133Q

MARCH 1, 2004

In my surrebuttal testimony, I respond to portions of the rebuttal testimonies of Mr. James D. Webber and Ms. Sherry Lichtenberg on behalf of MCI, and Mr. Mark David Van de Water on behalf of AT&T, with regard to BellSouth's hot cut processes. My surrebuttal testimony begins by addressing the Competing Local Providers' ("CLPs") criticism that BellSouth is unwilling to consider specific process changes proposed by the CLPs regarding the hot cut process. I respond that while the CLPs have chosen to make these criticisms via this docket as opposed to through operational channels, BellSouth has listened and in an effort to be responsive, agreed to make enhancements to its effective and seamless batch hot cut process.

Next, I respond to the CLPs' concerns regarding specifics of the batch hot cut process; specifically, hot cuts for Enhanced Extended Links ("EELs"), performing CLP-to-CLP migrations, web-based scheduling, same day cuts for end user accounts, interval reduction, a mechanized communication tool, SBC's process, window of time for cuts and after-hours/weekend cuts, and retail to UNE-L conversions.

I then address the CLPs' criticism as to the issue of scalability of the batch hot cut process and emphasize that BellSouth has a proven track record of staffing its centers

1 and network forces to accommodate changing and increasing loads and that

2 BellSouth's force model accounts for different fallout rates

3
4 Next, I respond to the CLPs' argument that BellSouth does not demonstrate its ability to
5 perform hot cuts at 'foreseeable' volumes by indicating that BellSouth has maintained
6 high due date performance rates and given the fact that CLPs have the ability to use the
7 batch migration process, which allows both the CLP and BellSouth extended intervals
8 for planning, it obviously follows that BellSouth's ability to perform hot cuts in large
9 quantities would only improve, given some idea of 'foreseeable' volumes from the CLPs.

10
11 Finally, in regard to the CLPs' concern over CLP planning and implementing the
12 necessary collocation arrangements and other facilities needed to provide switching, I
13 point out that the schedule, as outlined by the Federal Communications Commission
14 ("FCC") in the Triennial Review Order ("TRO"), allows sufficient time for any reasonable
15 CLP to fulfill their needs and that BellSouth should not be held accountable for poor
16 planning on the part of a CLP who chooses to procrastinate and wait until the end of the
17 27-month period to convert all of their UNE-Ps.

18
19 This concludes my executive summary.

1 **BELLSOUTH TELECOMMUNICATIONS, INC.**

2 **BEFORE THE**

3 **NORTH CAROLINA UTILITIES COMMISSION**

4 **DOCKET NO. P-100 Sub 133Q**

5 **SUMMARY OF THE SURREBUTTAL TESTIMONY OF**

6 **DR. DEBRA J. ARON**

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7
8 My surrebuttal testimony responds to the economic arguments made by various
9 CLEC witnesses that typically are based on one of several themes. The first such
10 theme reflects a desire to re-write the TRO more to the witnesses' liking, or a desire
11 to re-argue some of the positions that were considered and rejected by the FCC in
12 its determination of its rules. For example, MCI's Dr. Bryant and AT&T's Mr.
13 Wood counsel this Commission to simply ignore the FCC's requirement to
14 examine a "potential deployment" analysis. Mr. Wood argues that if potential
15 deployment indicates "no impairment" in markets that do not pass the triggers tests,
16 the results must be wrong, because we do not observe facilities deployment
17 sufficient to pass the triggers tests, and because we have observed failure in the
18 past. Besides being contrary to the directions provided by the FCC, and totally
19 irrelevant to the task at hand, such arguments fail to consider the economic fact that
20 CLPs select their method of competitive entry, such as UNE-P or UNE-L, *not*
21 solely on the basis of unimpairment, which is the topic of this proceeding, but also
22 on the basis of what is most profitable to the CLP given the options available. It is

1 therefore unreasonable from an economic perspective (as well as contrary to the
2 plain language of the TRO) to rely solely on actual deployment as a basis for
3 determining unimpairment.

4
5 A second set of criticisms involves the structure of the BACE model. For example,
6 there are subjective declarations by Mr. Wood that the model is overly sensitive,
7 and by Dr. Bryant that it is not sensitive enough. Such subjective criticisms are, of
8 course, without merit. In other instances, I believe that the basis of the criticisms of
9 the BACE model is a result of a misinterpretation by the witnesses of the model's
10 structure or how one goes about implementing an assumption change, or some
11 combination of these. Later in my testimony, I will clarify instances where parties
12 have misunderstood or misinterpreted the model. With regard to the various re-
13 runs of the BACE model, I have not been entirely successful in replicating all of
14 the results that have been described in the rebuttal testimonies. However, nothing
15 that I have seen, replicated, or attempted to replicate changes any of my
16 conclusions regarding the markets in which we have found that CLPs are
17 "unimpaired" without unbundled local switching, and to a large extent, these runs
18 demonstrate that my results are robust to a variety of assumption changes.

19
20 The third general area of complaint pertains to the parameter estimates that I
21 provided to the BACE model. In determining these estimates, I recognized that the
22 FCC is very clear that the potential deployment analysis should be based on an

1 efficient CLP using the “most efficient network architecture available” and
2 executing the “most efficient business model.” (TRO 517.) The FCC also notes
3 that it is appropriate to “weigh[] advantages and disadvantages” (TRO 517) that
4 may be available to the efficient CLP.

5
6 While these requirements provide substantial discretion, my approach is very
7 conservative. We model a generic, new CLP that seeks to enter the market without
8 any customers or any real-world advantages such as a brand name. My parameter
9 estimates, such as those regarding customer acquisition costs, General and
10 Administrative (“G&A”) expenses, and churn are developed from existing ILEC,
11 CLP, or industry data, which means that these estimates may be more conservative
12 than what an efficient CLP could attain. Moreover, where appropriate data were
13 available, I based my estimates on averages and midpoints rather than on best-of-
14 class (or better-than-existing) ILEC, CLP, or industry figures, even though these
15 best-in-class figures might arguably better represent the prospects of an efficient
16 CLP executing the most efficient business model.

17
18 The criticisms of my parameter value estimates either point to actual CLP
19 performance, or they seek to perversely handicap the hypothetical CLP, depending
20 on whichever contributes toward a finding of “impairment.” For example, several
21 of the witnesses claim that the assumed market penetration in the first year for
22 residential customers is too high. Notwithstanding the fact that they misinterpret

1 how the BACE model uses this data (it essentially cuts the market penetration in
2 half when computing revenues for the year), even a casual glance at reality would
3 demonstrate that real-world firms already have an existing base of UNE-P
4 customers and that they do not start from a base of zero, as the modeled CLP does.
5 Consistent with the FCC's directions, we could have modeled a CLP that begins
6 with some level of UNE-P-based customers (and revenues). Instead, we adopted
7 the conservative approach that the CLP starts with no customers at all. Witnesses
8 such as Mr. Wood and AT&T's Mr. Klick essentially argue that this is not
9 conservative enough for them. As I have noted, the fact that BACE models a
10 startup reflects substantial conservatism on our part. We legitimately could have
11 modeled a CLP as an existing, going concern with an existing base of UNE-P
12 customers. That we did not means that there may be more real-world "non-
13 impairment" than what is indicated by our BACE results.

14
15 As another example, there are criticisms of my recommended residential customer
16 acquisition costs. These costs were developed from *actual CLP expenses* as
17 reported to investment analysts. Dr. Bryant recommends that customer acquisition
18 costs be developed partly on the basis of what *wireless* companies incur, even
19 though these costs may include the cost of the handset. This is unreasonable. In
20 addition, as I describe later in my testimony, the use of actual CLP data to
21 determine customer acquisition costs is conservative because UNE-P-based CLPs
22 can have the incentive to spend inefficiently high amounts to acquire customers.

1

2 There are also criticisms of the prices that I recommend for use in the BACE
3 model. The FCC foresaw that price would be a contentious issue, and instructed us
4 to base the modeled prices on existing prices. I therefore developed prices on the
5 basis of existing CLP bundle prices and discounts from BellSouth's prices for *a la*
6 *carte* services. Consistent with the FCC's directions, we kept prices constant over
7 the entire time horizon of the model. Although not required by the TRO, to be
8 consistent, we kept costs constant as well, and did not adjust them downward for
9 any gains in productivity that an efficient CLP might arguably attain. In another
10 example of trying to re-write the TRO, several of the witnesses recommend that we
11 put prices on a downward trend based on speculation about the future (though none
12 noted or complained about our declining to impose a productivity factor on costs
13 over time).

14

15 In sum, the model that we present takes a cautious, conservative approach to
16 switch-based CLP entry. The services that the CLP is assumed to offer are services
17 that CLPs offer today, and the prices are based on prevailing prices. The costs
18 associated with customer acquisition, G&A, and the like also are based on industry
19 data. Our approach implements the FCC's requirement to consider an efficient
20 CLP, but it does not come close to testing the limits of that requirement. Our
21 results therefore should provide the Commission with a reasonable indication of the

1 prospects for successful economic entry by a switch-based CLP in the BellSouth
2 territory in North Carolina.
3
4 Section I of my surrebuttal testimony provides an overview. In Section II, I
5 respond to interpretations that other witnesses seek to ascribe to the FCC's
6 Triennial Review Order ("TRO"). In Section III, I respond to issues related to
7 competition. In Section IV, I respond to criticisms and misrepresentations of the
8 operations of the BACE model. In Section V, I respond to testimony regarding the
9 implementation of the "efficient CLP" requirement of the TRO. Finally, in Section
10 VI, I respond to criticisms of the various parameter values that I provided in the
11 BACE model.

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BEFORE THE
NORTH CAROLINA UTILITIES COMMISSION
DOCKET NO. P-100, SUB 133Q

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EXECUTIVE SUMMARY

SURREBUTTAL TESTIMONY OF
DR. RANDALL S. BILLINGSLEY, CFA
FILED MARCH 1, 2004

The purpose of my surrebuttal testimony is to critically evaluate the cost of capital-related portions of Mr. Don J. Wood's rebuttal testimony filed in this proceeding on behalf of AT&T Communications of the Southern States, L.L.C. ("AT&T"), which is dated February 16, 2004. My surrebuttal shows that most of Mr. Wood's testimony provides nothing more than unsupported speculations concerning competing local provider ("CLP") capital costs and the rest presents inconsistent and incorrect arguments that leave us with no evidence on current CLP capital costs. Importantly, Mr. Wood provides *absolutely no estimates* of CLP capital costs. Thus, his testimony provides no insight into the current capital costs faced by CLPs in general or any specific insight into the appropriate discount rate to be used in the BellSouth Analysis of CLEC Entry ("BACE") model.

Mr. Wood incorrectly argues that CLPs should be relied on exclusively to estimate the cost of capital used in the BACE model. In so doing he surprisingly speculates that CLPs that did not go bankrupt are, by definition, necessarily operating efficiently. As shown in my direct testimony in this proceeding, the average bond rating for a sample of market-traded CLPs is CCC+/CCC (see Billingsley Exhibit No. RSB-6). This is a *speculative-grade* bond rating that is associated with firms in financial distress. It is absolutely amazing that Mr. Wood argues that such firms should be used "... to make reasonable assumptions about efficient CLEC costs." The evidence obviously contradicts this. Further, Mr. Wood's reliance on unadjusted data drawn from *inefficient* CLPs is inconsistent with the Federal Communication Commission's assertion that the cost of capital should reflect a forward-looking, efficient network (see Triennial Review Order, In Re Review of the Section 251, Unbundling Obligations of Incumbent Local Exchange Carriers, First Report and Order on Remand and Further Notice of Proposed Rulemaking, FCC 03-36, released August, 21, 2003, pp. 419-420, §682).

After arguing that CLPs are currently operating efficiently, Mr. Wood also argues that current CLP capital structures are *not* efficient, target capital structures. This is patently inconsistent. On one hand he argues that CLPs are efficient and a reasonable source of representative capital costs. Yet on the other hand he argues that their current capital structure is not equal to their target, optimal capital structure. His only explanation for this contradictory speculation concerning current CLP capital structures is that they are the result of the "precipitous drop in the companies' stock prices." Mr. Wood's contradictory, inconsistent argument does not make sense. The truth that must be faced is that CLPs are not currently efficient in a comprehensive sense. It is consequently reasonable to use the averaging process

1 that I do to produce a representative bounded estimate of representative CLP capital costs.
2

3 As presented in my previously filed direct testimony in this proceeding, my cost of
4 capital estimation approach adapts to the data problems resulting from the current troubled
5 environment facing the CLP industry. I essentially provide "ceiling" and "floor" estimates of the
6 industry's capital costs. Thus, I use two surrogates to measure the representative CLP's capital
7 costs. I use the S&P 500 as a lower-bound or minimum estimate of the representative CLP's cost
8 of capital and I also use a sample of publicly-traded CLPs that provides an upper-bound or
9 maximum estimate of the representative CLP's cost of capital. I then provide a reasonable
10 estimate of the industry's overall capital costs by averaging the results of my two approaches.
11

12 My analysis indicates that a forward-looking cost of equity estimate for the representative
13 CLP is an average of 17.55%. I also find evidence that the cost of debt of the representative CLP
14 is an average of 9.92%. The average market value-based capital structure of firms is 58.50% debt
15 and 41.50% equity. Combining this average capital structure with the above average costs of
16 debt and equity produces an average pre-tax overall cost of capital for the representative CLP of
17 13.09%. This bounded averaging approach provides the most reasonable estimate of efficient
18 CLP capital costs in the current environment.
19

20 In summary, I recommend that the Commission use a *before-tax* overall cost of capital of
21 13.09% to determine the discount rate applied to the after-tax cash flows produced by the BACE
22 business case model.

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Clerk's Office
N.C. Utilities Commission

1 Bellsouth Telecommunications, Inc.

2 EXECUTIVE SUMMARY

3 SURREBUTTAL TESTIMONY OF ERIC FOGLE

4 BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

5 DOCKET NO. P-100, SUB 133Q

6 MARCH 1, 2004

7
8 In my surrebuttal testimony, I respond to portions of the rebuttal testimonies of Mr. Mark
9 David Van de Water on behalf of AT&T Communications of the Southern States, LLC.
10 ("AT&T") and Ms. Sherry Lichtenberg on behalf of MCI Metro Access Transmission
11 Services, LLC and Worldcom Communications, Inc. ("MCI"), as to criticisms of the
12 impact of BellSouth's batch ordering process on line splitting.

13
14 In response to criticism that the batch ordering process must change so that the
15 customer's line splitting arrangement is not taken down, I point out that line splitting
16 service is not compatible with a Unbundled Network Element Platform ("UNE-P")
17 arrangement and since Competing Local Providers ("CLPs") that use line splitting do
18 not, by definition, use UNE-P, there is no process that converts UNE-P customers to
19 UNE-Ls that will affect Digital Subscriber Line ("DSL") service of the end-user customer.

20
21 Next, I address the criticism that a process is not acceptable if it does not allow the
22 customer to retain their data provider when they move to UNE-L. I point out that if a
23 CLP is concerned about the impact a change in the switch provider for the voice service
24 would have on DSL service, then the CLP can easily address this concern by installing
25 and maintaining its own splitters, and performing the voice service UNE-P to UNE-L